

**REPORT OF THE AUDITOR-GENERAL TO THE WESTERN CAPE PROVINCIAL  
PARLIAMENT AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND  
PERFORMANCE INFORMATION OF THE KNYSNA MUNICIPALITY FOR THE  
YEAR ENDED 30 JUNE 2009**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying financial statements of the Knysna Municipality which comprise the statement of financial position as at 30 June 2009, and the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes as set out on pages 16 to 60.

**The accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the Standards of Generally Recognised Accounting Practice (Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2008 (Act No. 2 of 2008) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**The Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3)(a) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

6. Paragraph 11 *et seq.* of the Standards of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Knysna Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### **Opinion**

8. In my opinion the financial statements present fairly, in all material respects, the financial position of the Knysna Municipality as at 30 June 2009 and its financial performance and its cash flows for the year then ended, in accordance with the Standards of GRAP and in the manner required by the MFMA and DoRA.

### **Emphasis of matters**

Without qualifying my opinion, I draw attention to the following matters:

#### **Amendments to the applicable basis of accounting**

9. As set out in accounting policy note 1 to the municipality's financial statements, the municipality has adopted the transitional provisions as allowed by directive 4: "Transitional Provisions for the Adoption of Standards of GRAP by Medium and Low Capacity Municipalities" as issued by the Accounting Standards Board.

### **Material losses**

10. As disclosed in paragraph xx on page xx of the performance information, water distribution losses of 29% (1 286 mega litres) were incurred during the 2008-09 financial year.

### **Events after the reporting date**

11. As disclosed in note 49 to the financial statements, an amount of R22,9 million was awarded to the municipality by the National Treasury for drought alleviation. The Southern Cape is experiencing a severe drought, which resulted in the greater Knysna area being declared a disaster zone.

### Restatement of corresponding figures

12. As disclosed in notes 37 and 38 to the financial statements, the corresponding figures for 30 June 2008 have been restated as a result of errors discovered during the 2008-09 financial year in the financial statements of the Knysna Municipality at, and for the year ending, 30 June 2008.

### Material underspending on the budget

13. As disclosed in appendix E(1), the municipality has materially underspent on the budget for electricity services to the amount of R7 601 214. The underspending resulted from the fact that the expenditure budget for electricity services was increased to match the budgeted revenue, which was increased as a result of the electricity tariff increases as set out by the National Energy Regulator of South Africa. The municipality did not fully utilise the budgeted funds as the demand for electricity decreased.

### Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

### Unaudited supplementary schedules

14. The supplementary information set out on pages 61 to 70 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

### Governance framework

15. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the key governance responsibilities addressed below:

### Key governance responsibilities

16. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.	■	

No.	Matter	Y	N
<b>Quality of financial statements and related management information</b>			
2.	The financial statements were not subject to any material amendments resulting from the audit.		■
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	■	
<b>Timeliness of financial statements and management information</b>			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.	■	
<b>Availability of key officials during audit</b>			
5.	Key officials were available throughout the audit process.	■	
<b>Development and compliance with risk management, effective internal control and governance practices</b>			
6.	Audit committee		
	<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>	■	
	<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>	■	
	<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.</li> </ul>	■	
7.	Internal audit		
	<ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>	■	
	<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>	■	
	<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.</li> </ul>	■	

No.	Matter	Y	N
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.	■	
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.	■	
10.	The information systems were appropriate to facilitate the preparation of the financial statements.	■	
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.		■
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	■	
<b>Follow-up of audit findings</b>			
13.	The prior year audit findings have been substantially addressed.		■
14.	SCOPA resolutions have been substantially implemented.	Not applicable	
<b>Issues relating to the reporting of performance information</b>			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		■
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		■
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Knysna Municipality against its mandate, predetermined objectives, outputs, indicators and targets (section 68 of the MFMA).	■	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	■	

17. With the implementation of the Standards of GRAP, the municipality experienced difficulties in producing financial statements for audit purposes that were free from errors and omissions, although not in all instances material. This situation could have led to the qualification of the financial statements had the municipality not adjusted their financial statements during the audit, based on my findings.
18. This is indicative of a situation where:
- ongoing monitoring by the finance department is not effective enough to assess the effectiveness of internal control over financial reporting
  - policies and procedures related to financial reporting, which aim to improve the quality of reconciliations and maintenance of underlying records and, therefore, the accuracy and completeness of financial reporting, are not adequately established and communicated to staff in the finance department
  - management did not adequately identify risks relevant to accurate and complete financial reporting and actions were not taken to address such risks. These risks should be identified by way of a formal risk assessment process relating to the achievement of financial reporting objectives and/or by implementing a formal and regularly monitored financial management improvement plan, which includes actions to address not only the material findings arising from the prior year's external audit, but also the control and compliance deficiencies identified in that audit. The risk assessment process should inform the agendas of the audit committee and internal audit unit, which are essential elements in the review of the design and implementation of sound internal controls to achieve good governance and accountability over financial reporting.
19. Actions implemented by management to address the prior year audit findings during the 2008-09 financial year proved to be less effective than anticipated by management as a number of those findings recurred.
20. The next few years will pose greater challenges for the municipality with the ongoing transition to full compliance with the Standards of GRAP and the implementation of additional, approved Standards of GRAP. In order to deal with the prevalence of material misstatements in financial statements that have to be corrected during the audit, the municipality needs to:
- develop a strategy to improve financial management controls relating to compliance with accounting standards and reconciliation and maintenance of underlying accounting records, in order to produce accurate and complete financial statements
  - produce monthly financial accounts for review by management
  - subject the financial statements to a quality review before they are submitted for auditing, while the internal audit unit and audit committee can assist with evaluating the adequacy of the design and implementation of controls around the preparation of the financial statements.

21. The development of a performance management system that facilitates the preparation of a performance report that is accurate and complete and available for internal and external review in a timely manner, requires urgent attention from the accounting officer with the support of internal audit and the audit committee to ensure compliance with section 40 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **Report on performance information**

22. I was engaged to review the performance information.

### **The accounting officer's responsibility for the performance information**

23. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the MSA.

### **The Auditor-General's responsibility**

24. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
25. In terms of the foregoing my engagement included performing procedures of a review nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
26. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

## **Findings on performance information**

### **Non-compliance with regulatory requirements**

27. The municipality's performance management system policy framework does also not in all instances comply with the Local Government: Municipal Planning and Performance Management Regulations, 2001 (regulations), issued in *GNR.796 of 24 August 2001*, as:
- the framework does not specifically state that the performance targets must be practical and realistic as required by section 12(2) of the regulations
  - the framework does not state the importance of the set targets being commensurate with available resources and the municipality's capacity as required by section 12(1) of the regulations
  - the framework does not specifically indicate that the key performance indicators must be reviewed annually as required by section 11(1) of the regulations

- the framework does not specifically indicate that whenever the integrated development plan is amended, the key performance indicators that will be affected by such amendments must also be reviewed as required by section 11(2) of the regulations.
28. Furthermore, directors set their own targets which are not clearly linked to the service delivery and budget implementation plan, which results in the targets not being in line with the priorities, objectives, indicators and targets contained in the integrated development plan, as required by section 38(a)(iii) of the MSA.
29. The revised service delivery and budget implementation plan was not approved by the council, as required by section 54(1)(c) of the MFMA, after changes had been made to the budget.
30. The municipality did not display an advertisement to the local community offering them an opportunity to comment on the draft integrated development plan, as required by section 15 of the regulations.

#### **Performance information not received in time**

31. An assessment could not be performed of the reliability of the reported performance information, as set out on pages xx to xx of the annual report, since the information was not received in time for audit purposes.

#### **APPRECIATION**

32. The assistance rendered by the staff of the Knysna Municipality during the audit is sincerely appreciated.

*Auditor - General*

Cape Town

28 January 2010



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*